

# Instant Thoughts

**Ryan Lam, CFA**

Head of Research

ryan.lam@shacombank.com.hk

+852 2841 5283

**Marco Lau**

Treasury Research Manager

marco.lau@shacombank.com.hk

+852 2841 5450

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## Owing Your Own Shadow

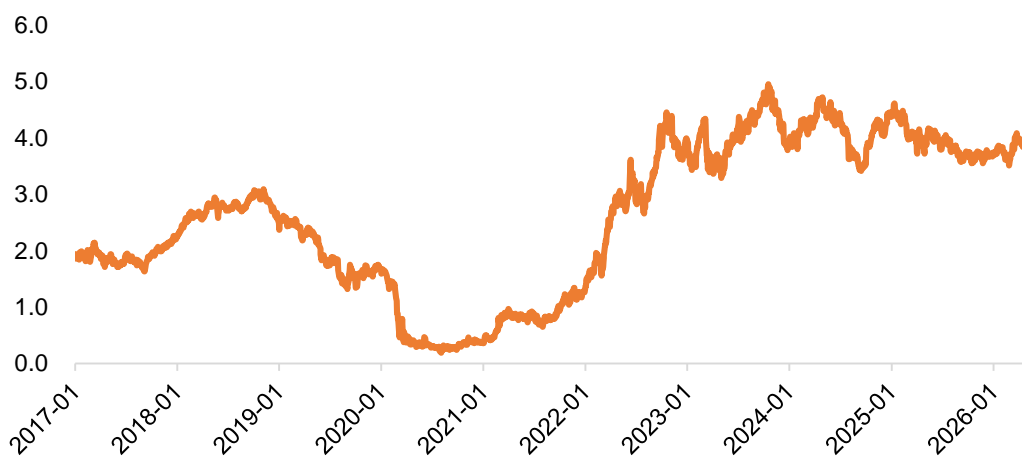
- The 10-year note yield rips higher and sailed past the much-watched 4.6% threshold.
- Money manager finally lost their patience as the US-Iran peace talk is huge on pomp but light on breakthroughs. They learned to ask if it's wiser to save the dry power for rally chasing than dip buying. The mentality reset isn't a clear setup for mean-reversion.
- Politicians nowadays are too much the crowd-pleaser to whittle down the welfare state. A return of fiscal prudence looks more fleeting than ever.
- Going forward, the Fed could float a trial balloon about a resumption of a rate-hike campaign. The crystallization of a tightening threat will probably induce a bear flattening.
- Alternatively, the tariff tantrums and war-induced price shock fizzle out. For two decades plus, the 30-year yield stays above 5% level for an average of 11 days. Any hesitation would result in a bull steepening.

Sovereign bond is a sector Kevin Warsh frowned upon. The 10-year note yield rips higher and sailed past the much-watched 4.6% threshold. It is now spiraling to re-test 4.66%, a level last seen in February 2025.

The Gulf war has been a disaster on so many levels. The overreach of monetary statecraft is one of them. Throwing the risk of another repocalypse into back burner, the Fed announced this month to scale back its monthly pumping from US\$25 billion to US\$10 billion into the interbank ecosystem. With a snap of a finger, any lingering doubt about the Fed's paternalistic desire to keep rates subdued vanishes in a puff of smoke. The deliberate destruction of excess reserves certainly seems overkill now.

What we see in the detail, however, is that the shakeout of the U.S. 5-year Treasuries (Exhibit 1). The belly segment had once been so anchored that few could foresee the rate disorder a few weeks ago. Money manager finally lost their patience as the US-Iran peace talk is huge on pomp but light on breakthroughs. They learned to ask if it's wiser to save the dry power for rally chasing than dip buying. Above all, bond traders are past denial, anger and bargaining, and well on their way to depression and acceptance of the possibility of a hike cycle. Gamma mechanics that mechanically added billions of dollar on down days flipped into block sales that we read from the headlines. The mentality reset isn't a clear setup for mean-reversion.

Exhibit 1: US Treasury 5-year Yield (%)



Source: Bloomberg, Shanghai Commercial Bank

A similar faultline run through the public realm. A ruinous spike in yield was once believed to pressure populists to back down. In reality, non-populist rivals found themselves so jeered by tax-fatigued voters. Politicians nowadays are too much the crowd-pleaser to whittle down the welfare state. A return of fiscal prudence looks more fleeting than ever.

We are at the crossroads now. The tightening bias will fall to pieces should the Gulf war come to a sudden and conclusive end. This utopian outcome is well understood by market participants. A parallel path is that the Fed brings back its old playbook, by floating a trial balloon about a resumption of a rate-hike campaign. Going down this route, the crystallization of a tightening threat will probably induce a bear flattening.

Alternatively, the tariff tantrums and war-induced price shock fizzle out. For two decades plus, the 30-year yield stays above 5% level for an average of about 11 days. By then, you have to ask if you're willing to pick an uphill fight. Any hesitation would result in a bull steepening, though such a transition will take time too.

#### Exhibit 2: Major Periods with 30-Year Treasury Yield Above 5% (Since 2005)

Period Start	Period End	Duration (Trading Days)
12/04/2006	03/08/2006	82
07/08/2006	15/08/2006	7
25/05/2007	25/07/2007	44
12/05/2026	Ongoing	6
<b>Average (All Periods)</b>		<b>11</b>

Source: Bloomberg, Shanghai Commercial Bank

In finance, there are no bad ideas, only good ideas taken too far. At this junction, we should respect the asymmetry between a consensus of post-shock disinflation and a mix of A.I. continuation/fiscal woes that challenge this narrative.

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